

TEACHERS' RETIREMENT BOARD

INVESTMENT COMMITTEE

SUBJECT: Alternative Investments
Activity Status Report

ITEM NUMBER: 15

ATTACHMENT(S): 4

ACTION: _____

DATE OF MEETING: November 3, 1999

INFORMATION: X

PRESENTER(S): Mr. Desrochers

The table below contains Alternative Investment activity for the month of September 1999 and historical information for selected time periods. A report on the status of the portfolio at the quarter ended September 30, 1999 is provided in Attachment 1.

	Month Ended 9/30/99	Fiscal Year To Date	Past One Year	Past Three Years	Past Five Years
<u>Commitments:</u>					
Partnerships	\$ 0	\$ 45,000,000	\$ 804,625,000	\$ 3,180,320,477	\$ 3,803,773,866
Co-Investments	0	24,999,996	24,999,996	41,999,996	71,999,996
Secondaries	70,773,417	70,773,417	80,067,245	80,067,245	80,067,245
	\$ 70,773,417	\$ 140,773,413	\$ 909,692,241	\$ 3,302,387,718	\$ 3,955,841,107
<u>Contributions:</u>					
Partnerships	\$ 39,720,133	\$ 221,797,814	\$ 736,996,361	\$ 1,776,461,595	\$ 2,306,367,025
Co-Investments	0	24,999,996	24,999,996	41,999,996	71,999,996
Secondaries	55,424,219	55,532,630	63,294,459	63,294,459	63,802,564
Mgmt. Fee (Outside)	(42,139)	1,792,840	8,904,137	23,110,926	31,436,334
	\$ 95,102,213	\$ 304,123,280	\$ 834,194,952	\$ 1,904,866,976	\$ 2,473,605,919
<u>Distributions:</u>					
Cash	\$ 71,918,716	\$ 119,371,662	\$ 419,301,735	\$ 1,050,979,885	\$ 1,287,269,547
Stock	24,729,377	55,370,021	213,616,283	424,052,753	576,094,745
	\$ 96,648,093	\$ 174,741,683	\$ 632,918,017	\$ 1,475,032,638	\$ 1,863,364,292
Stock Sales	\$ 14,653,110	\$ 61,345,815	\$ 221,128,331	\$ 382,458,944	\$ 525,314,246

Attachments 2, 3, and 4 provide executive summaries of actions taken under delegation of authority for commitments of \$100 million to Vestar Capital Partners IV; \$10 million to Summit Accelerator Fund; and \$60 million to NEA IX, respectively.

Note: Attachment 1 is not available in electronic format at this time.

Alternative Investments

EXECUTIVE SUMMARY OF ACTION TAKEN
UNDER DELEGATION OF AUTHORITY
SUMMIT ACCELERATOR FUND, L.P.

Action: Commit \$10 million to Summit Accelerator Fund, L.P. (SAF) which represents 6.7% of the total capitalization of the fund.

Background: Summit was formed in 1984 by Roe Stamps and Stephen Woodsum. These partners had previously worked together as executives of First Chicago Investment Corporation, and as General Partners of TA Associates, prior to co-founding Summit.

Because of Summit's proactive investment origination strategy, Summit generates investment opportunities where the prospective investment size is smaller than the focus of Summit's previous funds. Many of these opportunities are attractive companies with smaller investment requirements. SAF has been established to provide an investment vehicle for these attractive companies with smaller financing needs.

CalSTRS is currently an investor in three Summit equity funds, and two subordinated debt funds. In 1992 CalSTRS committed \$15 million to Summit III, \$10 million to Summit Sub Debt in 1994, \$30 million to Summit IV in 1995, \$20 to Summit Sub Debt II in 1997, and \$45 million in Summit V in 1998. In total, CalSTRS has committed \$120 million to Summit Partners.

Analysis: SAF qualifies as a new fund as identified in the Alternative Investments' policies.

SAF's investment strategy will be modeled closely on Summit's investment strategy. Key components of the Fund's investment strategy will include:

- Be the lead or co-lead investor;
- Be the first professional investor;
- Invest in companies that have revenue momentum and are profitable or approaching profitability;
- Invest in senior securities; and
- Obtain board seats or observation rights.

Executive Summary

The General Partners believe that by leading investments and being the first professional investor it can generally negotiate lower valuations and significantly better terms and deal structures that will minimize risks and maximize returns. By investing in companies with rapidly growing revenues that are profitable or approaching profitability, SAF will work with disciplined entrepreneurs who have demonstrated an ability to manage under the constraints of limited resources. Board representation or board observer rights will give the fund significant management influence over its portfolio companies, and structuring its investments as senior securities will help preserve capital and minimize risk. SAF will provide expansion capital and assist entrepreneurs on strategic issues that rapidly growing companies often face due to short product life cycles and increased competition from rapidly growing markets. The target size of SAF's investments is expected to range from \$1 million to \$7.5 million.

- Investment Thesis:
- 1) The Summit Accelerator Fund is consistent with approved targets and ranges to invest 10% to 20% of the Alternative Investment portfolio in venture capital partnerships.
 - 2) The Summit Funds have consistently generated investment returns in excess of the Venture Economics Upper Quartile Benchmark.
 - 3) The management team are very experienced venture capitalists.
 - 4) The SAF investment strategy provides a good fit in the CalSTRS' portfolio.
 - 5) Summit Partners have been identified as a Tier 1 Manager.
 - 6) Staff has received a positive investment recommendation from Pathway Capital Management.

Policy Compliance: This decision complies with the portfolio's policies and procedures, which were approved by the Investment Committee on June 3, 1998. A positive written recommendation by the Alternative Investment's advisor and CalSTRS' staff has been documented. This resulted after an investment analysis and due diligence was conducted in the manner as previously reviewed and approved by the Investment Committee.

Executive Summary

Recommendation: Staff recommends that CalSTRS commit \$10 million to Summit Accelerator Fund. CalSTRS' commitment is subject to the successful negotiation of partnership terms and legal review.

By:

Trish Taniguchi
Investment Officer

Date_____

Approved:

Réal Desrochers
Director of Alternative Investments

Date_____

Patrick Mitchell
Chief Investment Officer

Date_____

SUMMIT ACCELERATOR FUND, L.P.

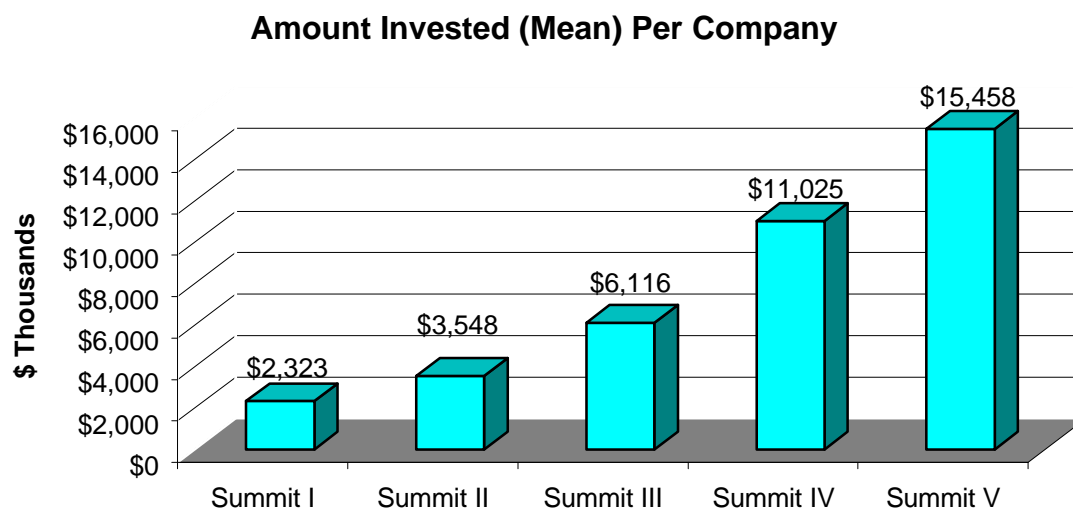
The Summit Accelerator Fund, L.P. (SAF) is being formed as a private equity fund in partnership with Summit Partners. SAF will work closely with Summit to invest principally in emerging growth companies in the information technology and services sectors. The principals are seeking \$150 million in commitments from the existing limited partners in Summit V. The Summit principals will commit \$10 million to the partnership. Staff recommends that CalSTRS invest \$10 million in Summit Accelerator Fund, L.P.

HISTORY OF FIRM

Summit was formed in 1984 by Roe Stamps and Stephen Woodsum. These partners had previously worked together as executives of First Chicago Investment Corporation, and as General Partners of TA Associates, prior to co-founding Summit.

Since its inception in 1984, Summit's overall investment strategy has been to utilize proactive investment origination techniques to find and create investment opportunities, principally in profitable emerging growth companies, often before the companies are seeking capital. Summit attempts to maximize investor returns by pursuing companies with no professional investors and emphasizes capital preservation by structuring investments as senior securities. Summit also generally leads or co-leads investments and obtains board seats or board observation rights. The firm has established offices in both Boston and Palo Alto.

CalSTRS is an investor in each of Summit's previous funds. Summit has raised five previous equity funds which focus on making investments in private and profitable emerging growth companies and leveraged transactions. Additionally, the Summit group has raised two subordinated debt funds. As illustrated in the following chart, the size of Summit's equity investments has grown with the size of successive funds. The average Summit investment size is now approximately \$15.5 million.



Because of Summit's proactive investment origination strategy, Summit generates investment opportunities where the prospective investment size is smaller than the focus of Summit V. Many of these opportunities are attractive companies with smaller investment requirements. SAF has been established to provide an investment vehicle for these attractive companies with smaller financing needs.

CalSTRS is currently an investor in three Summit equity funds, and two subordinated debt funds. In 1992 CalSTRS committed \$15 million to Summit III, \$10 million to Summit Sub Debt in 1994, \$30 million to Summit IV in 1995, \$20 to Summit Sub Debt II in 1997, and \$45 million in Summit V in 1998. In total, CalSTRS has committed \$120 million to Summit Partners.

INVESTMENT STRATEGY

SAF's investment strategy will be modeled closely on Summit's investment strategy. Key components of the Fund's investment strategy will include:

- Be the lead or co-lead investor;
- Be the first professional investor;
- Invest in companies that have revenue momentum and are profitable or approaching profitability;
- Invest in senior securities; and
- Obtain board seats or observation rights.

The General Partners believe that by leading investments and being the first professional investor it can generally negotiate lower valuations and significantly better terms and deal structures that will minimize risks and maximize returns. By investing in companies with rapidly growing revenues that are profitable or approaching profitability, SAF will work with disciplined entrepreneurs who have demonstrated an ability to manage under the constraints of limited resources. Board representation or board observer rights will give the fund significant management influence over its portfolio companies, and structuring its investments as senior securities will help preserve capital and minimize risk. SAF will provide expansion capital and assist entrepreneurs on strategic issues that rapidly growing companies often face due to short product life cycles and increased competition from rapidly growing markets. The target size of SAF's investments is expected to range from \$1 million to \$7.5 million.

DEAL FLOW

In addition to the referral networks of the Fund's own investment professionals, SAF will have access to Summit's internally generated investment opportunities. SAF expects that Summit's investment origination techniques will identify attractive investment opportunities that are too small for Summit's investment criteria, but are ideally suited for SAF. The Summit deal origination strategy consists of three primary components:

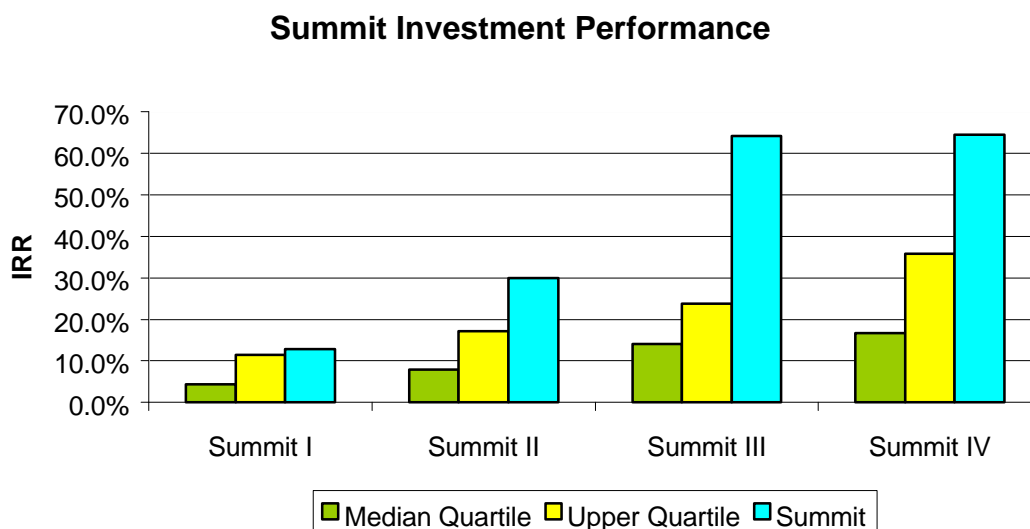
1. *Search and origination.* Summit originates a major portion of its investment opportunities internally by identifying and researching industries of interest and actively

pursuing the leading companies within those industries. Summit identifies opportunities through a disciplined program which includes attending trade exhibitions and conferences, researching industry periodicals and newspapers, and “cold calling” the chief executives of prospective portfolio companies.

2. *Industry Contacts.* Summit’s industry contacts generate a significant number of investment opportunities. These contacts include entrepreneurs, venture capitalists, investment bankers, accountants, lawyers, placement firms, and consultants.
3. *Proprietary Database.* Summit maintains a proprietary database, totaling over 65,000 companies, which enables Summit’s staff to monitor the development of potential portfolio companies.

INVESTMENT PERFORMANCE

The table below shows Summit’s investment performance since 1984. As shown below, the Summit Funds have consistently outperformed the Venture Economics Upper Quartile Benchmark.



MANAGEMENT TEAM

SAF will be managed by its own investment professionals with the active participation of Summit’s investment professionals. The initial member of SAF Partners is Christopher W. Sheeline. SAF anticipates adding one to two additional partners and two to three additional professionals. Mr. Sheeline, with the assistance of Summit, is currently actively conducting a search for a partner with significant private equity investment and/or operating experience. The Partners have a vesting schedule of 15% per year for the first five years, and then 5% per year for the next five years thereafter.

Summit will play an active role in the formation, management and operation of the Fund. Summit will assist the fund in its fundraising, and individual members of Summit Partners will invest \$10 million in the Fund. Summit's staff of over 30 professionals will be available to assist the Fund, particularly in the generation of investment opportunities. Gregory M. Avis, a Managing General Partner of Summit Partners, will oversee Summit's involvement with the Fund. It is anticipated that Mr. Avis will dedicate approximately 30% of his time to activities related to SAF. In addition, an Investment Committee, consisting of two members of Summit Partners (initially Gregory M. Avis and Bruce R. Evans) and the members of SAF will approve all investments. Both of the representatives of Summit Partners on the Investment Committee must approve each SAF investment. Please refer to Attachment A for detailed biographies of the Summit professionals.

SIGNIFICANT TERMS

CalSTRS' investment is subject to successful negotiation of partnership terms. Aggregation of profits and losses will be allocated 75% to the Limited Partners and 25% to the General Partners. The General Partners will commit \$10 million, which represents 6% of the Fund. The annual management fee will be 2% of committed capital in years one through ten. Management fees will be reduced by 75% of directors' fees, consulting fees, or any transaction fees paid by portfolio companies to the General Partner. Management fees will be paid inside the committed capital amount. Please refer to Attachment B for a more detailed summary of significant terms.

CONCERNS

Staff has identified one area of concern which relates to the venture capital experience of Christopher Sheeline. Mr. Sheeline joined the Summit team in May 1999 and has no previous experience as a General Partner of a venture capital limited partnership. During the prior 11 years, he was an investment banker with Hambrecht & Quist (H&Q), where for the last five years he served as Managing Director of the Communications Industry investment banking organization and was active in private equity investing. During his tenure at H&Q, Mr. Sheeline gained numerous industry contacts and developed extensive knowledge and expertise in the industry in which SAF intends to invest. Additionally, the Summit investment professionals will be working closely with Mr. Sheeline and SAF will have access to all of the Summit resources. Of equal importance is the Investment Committee structure required for each SAF investment. As mentioned previously, the Investment Committee will consist of the SAF partner plus two General Partners from the Summit team. Investments will not be made without the approval of both of the representatives from Summit Partners. Staff is comfortable that the management of the fund and the primary investment decisions will be closely monitored and governed by the Summit partners.

INVESTMENT THESIS

Staff recommends that CalSTRS invest \$10 million in Summit Accelerator fund, L.P. for the following reasons:

- The Summit Accelerator Fund is consistent with approved targets and ranges to invest 10% to 20% of the Alternative Investment portfolio in venture capital partnerships.
- The Summit Funds have consistently generated investment returns in excess of the Venture Economics Upper Quartile Benchmark.
- The management team are very experienced venture capitalists.
- The SAF investment strategy provides a good fit in the CalSTRS' portfolio.
- Summit Partners have been identified as a Tier 1 Manager.
- Staff has received a positive investment recommendation from Pathway Capital Management.

By:

Trish Taniguchi
Investment Officer

Date _____

Recommended By:

Réal Desrochers
Director of Alternative Investments

Date _____

Approved:

Patrick Mitchell
Chief Investment Officer

Date _____

Summary of STRS Review Process

Staff has extensive knowledge and experience with the Summit team. CalSTRS is currently an investor in three Summit equity funds, and two subordinated debt funds. In 1992 CalSTRS committed \$15 million to Summit III, \$10 million to Summit Sub Debt in 1994, \$30 million to Summit IV in 1995, \$20 to Summit Sub Debt II in 1997, and \$45 million in Summit V in 1998. In total, CalSTRS has committed \$120 million to Summit Partners. Staff is in regular contact with the Summit partners, has met with previous Summit partners, and regularly attends the Summit annual meetings.

As part of staff's due diligence, staff met with the Summit General Partners and the SAF General Partner regarding an investment in SAF. Additionally, the General Partners responded to an extensive due diligence questionnaire that was designed by staff. The questionnaire provides staff with detailed information regarding the General Partner's investment strategy, investment philosophy, history of the firm, depth of the management team, economic alignment, due diligence and investment decision-making process. The questionnaire also provides investment performance history—both at the Fund level and portfolio company level. Staff reviewed and the information contained in the response to the questionnaire plus the private placement memorandum. After extensive analysis of the Summit questionnaire, meeting with the General Partners, and staff's existing knowledge of the Summit team, staff is recommending a \$10 million investment in Summit Accelerator Fund, L.P.

MANAGEMENT OF THE FUND

SAF's office is located in Palo Alto, California at Summit's offices. This location was chosen because of the strong base of emerging growth companies in California's Silicon Valley and Summit's previous successes in this region. SAF plans to locate one or more SAF professionals in Summit's Boston office over time to leverage the strong deal origination capabilities and resource base of that office.

Christopher W. Sheeline, Member of SAF Partners

Mr. Sheeline joined the Summit team in May, 1999. During the prior 11 years, he was an investment banker with Hambrecht & Quist, where for the last five years he served as Managing Director of the Communications Industry investment banking organization and was active in private equity investing. Prior to focusing on communications, he served as a generalist technology banker with an emphasis in software, multimedia technology and communications. From 1987 to 1988, Mr. Sheeline was a principal with H&Q Technology Partners focusing on strategic merger and acquisition transactions. From late 1984 to early 1987, he was responsible for Technology Planning at PacTel Corporation, the unregulated subsidiary holding company of Pacific Telesis Group. He began his career in 1983 at Oracle Corporation where he worked in software development and international marketing. Mr. Sheeline received his B.A., M.A. and Ph.D. from Stanford University.

Private equity investments at Hambrecht & Quist which Mr. Sheeline initiated or sponsored included Assured Access Technologies; Corsair Communications; Navis; Rapt Technologies; STAR Telecom; Subscriber Computing, and a number of other companies. His investment banking clients at H&Q included Advanced Fibre Communications; ALANTEC Corporation; Broadvision; Catapult Communications; Citrix Systems; Corsair Communications; Excel Switching; @Home, Networks; Innova Corporation; Netscape Communications; Network Solutions; PairGain Technologies; Pinnacle Systems; SoftImage; STAR Telecom and UUNet Technologies, among others.

Summit Partners

Summit's staff of over 30 investment professionals will assist in the operation and management of SAF. The Fund believes that the training, experience and motivation of Summit's professional staff distinguishes Summit in the private equity industry and will be a key factor of the Fund's success in originating, structuring and leading outstanding investments. The eleven members of Summit Partners are as follows:

Managing General Partners

Gregory M. Avis
E. Roe Stamps, IV
Stephen G. Woodsum

General Partners

Peter Y. Chung
Bruce R. Evans
Walter G. Kortschak
Martin J. Mannion
Kevin P. Mohan
Thomas S. Roberts
Joseph F. Trustey
Thomas F. Farb (CFO)

Gregory M. Avis, Managing General Partner of Summit Partners

Mr. Avis worked in the corporate finance departments of Goldman, Sachs & Company and McDonald & Company prior to joining Summit at its formation in 1984. He manages Summit's Palo Alto office and has served on the board of numerous private and public companies, including Clontech Laboratories, Inc.; CMG Information Services, Inc.@ COMPS.COM; Digital Link Corporation; Ditech Communications Corp.; Integrated Systems, Inc.; Powerwave Technologies, Inc.; and Splash Technology Holdings, Inc. Mr. Avis received a B.A. degree, *cum laude*, in Political Economy from Williams College and an M.B.A., with Distinction, from Harvard Business School.

Bruce R. Evans, General Partner of Summit Partners

Mr. Evans began his career in private equity investing with Summit in 1986. Prior to joining Summit, he worked for the corporate finance department of Salomon Brothers Inc. and as a Marketing Representative with IBM Corporation. Mr. Evans has served as a Director of A+ Network, Inc.; DSET Corporation; Hyperion Software Corporation; Omtool, Ltd.; Private Business, Inc.; Pediatrix Medical Group, Inc.; Renal Treatment Centers, Inc., and numerous private companies. Mr. Evans received a B.E. degree, *magna cum laude*, in Mechanical Engineering and Economics from Vanderbilt University and an M.B.A., with first year Honors, from Harvard Business School.

SUMMARY OF TERMS

The following summary of the Summit Accelerator Fund, L.P., a Delaware limited partnership, is qualified in its entirety by information appearing in this Memorandum and the Fund's limited partnership agreement (the "Limited Partnership Agreement").

The Partnership	The Summit Accelerator Fund, L.P. (the "Fund" or the "Partnership"), a Delaware limited partnership.
Purpose	The principal purpose of the Partnership is to achieve significant long-term capital appreciation by acquiring equity securities in private emerging growth companies.
General Partner	The general partner of the Partnership is Summit Accelerator Partners, L.P. (the "General Partner"), a Delaware limited partnership. The partners of the General Partner are anticipated to be (i) Summit Partners, LLC, a Delaware limited liability company ("Summit Partners"), the managing members of which are Gregory M. Avis, E. Roe Stamps, IV and Stephen G. Woodsum; and the other members of which are Peter Y. Chung, Bruce R. Evans, Thomas F. Farb, Walter G. Kortschak, Martin J. Mannion, Kevin P. Mohan, Thomas S. Roberts, and Joseph F. Trustey, or an affiliated entity and (ii) SAF Partners, LLC, the initial member of which is Christopher W. Sheeline. The General Partner, as general partner of the Fund, will contribute capital equal to one percent of the capital contributed by the Limited Partners (as defined below).
Management Fee	The Fund will pay the General Partner an annual management fee equal to two percent of committed capital in years one through ten. These fees will be reduced by directors' fees, consulting fees, or any transaction fees paid by portfolio companies to the General Partner. A management company affiliated with Summit Partners will provide certain management and administrative services to the Partnership.
Summit Investment	The members of Summit Partners will contribute, on the same schedule as the Limited Partners, an additional \$10 million of limited partnership interests.

Allocation of Profit and Losses

Generally, 75 percent to the General Partner and Limited Partners (the "Partners") on the basis of capital and 25 percent to the General Partner. Income from short-term investments and net operating expenses shall be allocated on the basis of paid-in capital contributions.

Distribution Priority

Distributions of cash or securities will be made at the discretion of the General Partner. It is anticipated, however, that net ordinary income will be distributed at least annually, and net investment gains realized in cash will be distributed regularly. Distributions to cover tax liabilities of the Partners may be made annually if all other distributions made are not sufficient to cover such liability.

In general, prior to the time that the Limited Partners have received distributions equal to their capital commitments (the "Payout") securities and net proceeds realized on the sale of securities will be distributed (i) 75 percent to the Partners in proportion to their capital contributions and (ii) 25 percent to the General Partner. However, no such distributions (except to pay anticipated tax liabilities) will be made to the General Partner pursuant to clause (ii) of the preceding sentence if the fair market value of the capital accounts (capital accounts adjusted to reflect unrealized gains and losses) of the Limited Partners plus amounts previously distributed to the Limited Partners do not equal at least 10 percent of the Limited Partners' capital contributions. If this fair value test is satisfied, distributions will be made first to the General Partner until the General Partner receives 25 percent of all distributions made to the Partners. After Payout, all such distributions will be made to the Partners in proportion to their capital accounts.

Alternative Investments

EXECUTIVE SUMMARY OF ACTION TAKEN
UNDER DELEGATION OF AUTHORITY
NEA IX, L.P.

Action: Commit \$60 million to NEA IX, L.P. which represents approximately 8.6% of the total capitalization of the fund.

Background: NEA was founded in 1978 by Frank Bonsal, Richard Kramlich, and Charles Newhall to invest in early stage venture capital companies. Over the past 21 years, the NEA partners have formed eight limited partnerships and have established their team as one of the premier venture capital groups in the industry.

CalSTRS is currently an investor in four NEA partnerships. CalSTRS committed \$25 million to NEA V in 1990, \$35 million to NEA VI in 1993, \$40 million to NEA VII in 1996, and \$50 million to NEA VIII in 1998.

Analysis: NEA qualifies as a follow-on fund as identified in the Alternative Investments' policies.

NEA IX will invest in and provide assistance to new and emerging growth-oriented businesses with superior profit-making potential. The investment objective will be to achieve a high level of capital appreciation over the life of the partnership. The portfolio companies in which the partnership will invest in will be located principally in the United States, and will focus primarily on the information technology and medical and life sciences sectors. The partnership is geographically diversified with offices in Menlo Park, California, Baltimore, Maryland, and Reston, Virginia, which enables the partnership to react quickly to new investment opportunities and portfolio company issues. The Partnership will focus its investment interest on well managed companies operating, or proposing to operate in, markets which are capable of using equity capital efficiently in the creation of their products and services.

Investment Thesis: Staff is recommending an investment in NEA IX for the following reasons:

- Staff has identified NEA as a Tier 1 partnership.
- The NEA funds consistently generate investment returns that exceed the Venture Economics Upper Quartile Benchmark.
- NEA's venture capital strategy is consistent with the targets and ranges which have been approved by the Investment Committee to invest 16% of the Alternative Investment portfolio in venture capital limited partnerships.

- The NEA investment strategy provides a good fit in the STRS portfolio. There is very little overlap with STRS' other venture capital partnerships.
- Staff has received a positive investment recommendation from Pathway Capital Management.

Policy Compliance: This decision complies with the portfolio's policies and procedures, which were approved by the Investment Committee on June 3, 1998. A positive written recommendation by the Alternative Investment's advisor and CalSTRS' staff has been documented. This resulted after an investment analysis and due diligence was conducted in the manner as previously reviewed and approved by the Investment Committee.

Recommendation: Staff recommends that CalSTRS commit \$60 million to NEA IX. CalSTRS' commitment is subject to the successful negotiation of partnership terms and legal review.

By:

Trish Taniguchi
Investment Officer

Date_____

Recommended By:

Réal Desrochers
Director of Alternative Investments

Date_____

Approved:

Patrick Mitchell
Chief Investment Officer

Date_____